

INITIAL STATEMENT OF REASONS

Adoption of new sections 578 and 578.1 - Determination of "Employee" Status

Description of Public Problem, Administrative Requirement, or Other condition or Circumstance that the Regulation is Intended to Address:

CalPERS is often called upon to determine whether an individual is an employee of a CalPERS-covered agency who may be eligible for CalPERS' membership for retirement benefits. A determination of employee status is crucial because a) retirement benefits by law may only be provided to designated employees, and b) in order to preserve the federal tax-qualified status of the system, CalPERS must ensure it provides retirement benefits only to the common law employees of the state, school employers and contracting agencies. Under Internal Revenue Code section 401(a), a requirement for pension plan qualification (and exemption from federal taxation) is that the plan of an employer must be for the "exclusive benefit" of the employer's employees and their beneficiaries.

The CalPERS Board of Administration (Board) has specific authority under Government Code section 20125 to "determine who are employees and is the sole judge of the conditions under which persons may be admitted to and continue to receive benefits under this system." Government Code section 20028 generally defines "employee" as "any person in the employ of" the state, a school employer or a contracting agency. Because the definition of "employee" is general, CalPERS has historically looked to the common law to determine employee status for CalPERS retirement purposes.

In recent years, a California Supreme Court decision and a CalPERS Board Precedential Decision have confirmed that the common law employment factors should be used when determining whether an individual is an employee of a CalPERS contracting agency and is eligible for CalPERS retirement benefits. The proposed regulations incorporate the common law factors into any employee determination performed regardless of whether the individual performs services for the state, school employers or contracting agencies.

Specific Purpose: To codify the common law employment factors into the interpretation of Government Code sections 20125 and 20028 and to make specific the criteria used to determine whether an individual is the employee of a CalPERS-covered employer.

Necessity: To preserve the tax-qualified status of the retirement system, CalPERS must ensure it determines employee status utilizing the common law employment test when determining whether individuals providing services to the state, school employers and contracting agencies are eligible for CalPERS' membership.

The proposed regulations are intended to incorporate the common law factors, as discussed in California case law, to determine employee status under

Government Code sections 20125 and 20028. CalPERS long-standing practice has been to utilize common law requirements to determine employee status. Over the years, there have been a number of questions and various challenges relating to whether CalPERS should use the common law employment test to determine employee status. In 2004, the California Supreme Court confirmed that the common law factors were to be used to determine if individuals were employees of the Metropolitan Water District (a CalPERS employer) for the purposes of CalPERS' eligibility. (*Metropolitan Water District v. Superior Court* (2004) 32 Cal. 4th 491; often referred to as the "Cargill" decision.)

After the *Cargill* decision, the CalPERS Board of Administration adopted as precedential its decision entitled *In the Matter of the Application for CalPERS Membership Credit by Lee Neidengard v. Tri-Counties Association for the Developmentally Disabled* (Case No. 05-01), a case which determined whether Lee Neidengard served as an employee or independent contractor when performing service for Tri-Counties Association. In this precedential decision, the Board cited the case of *Tieberg v. Unemployment Ins. App. Bd.* (1970; 2 Cal.3d 943), which articulated the common law factors for making such a determination. Citing to *Cargill*, the Board also concluded in *Neidengard* that since the Public Employees' Retirement Law does not define "independent contractor" or "employee" of a contracting agency with greater particularity, these terms must be defined with reference to the common law factors.

The proposed regulations incorporate the factors discussed in the *Tieberg*, *Cargill* and *Neidengard* decisions to interpret sections 20125 and 20028 and to make specific the criteria used to determine employee status for CalPERS retirement purposes. The adoption of these regulations will benefit the public, CalPERS' employers and members and assist CalPERS' staff by setting forth the factors to be considered when determining if individuals are employees of the state, school employers and contracting agencies and by reducing administrative appeals and litigation over the question of who is an employee.

Technical, Theoretical and/or Empirical Studies, Reports or Documents: Not applicable.

Alternatives to the Regulatory Action and CalPERS' Reasons for Rejecting Those Alternatives: CalPERS has considered alternatives to this proposal, and has determined that there is no more effective way to carry out its purpose that would be less burdensome. The alternative of adopting no regulation would be less effective and would not lead to the anticipated benefits expected from the proposed action.

Alternatives to the Regulatory Action that Would Lessen any Adverse Impact on Small Businesses: The proposed action has no cost impact on small businesses because it applies only to public agency employee retirement benefits.